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In the Supreme Court of the United States

OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC., PETITIONER

v.

MANUEL KAPLAN, CAROL KAPLAN & M.K. INVESTMENTS, INC., RESPONDENTS

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF FOR THE PETITIONER

STEPHEN P. BEDELL
TIMOTHY G. MCDERMOTT
Gardner, Carton & Douglas
321 North Clark Street
Chicago, Illinois 60610

KENNETH E. WILE
Bank of America National Trust & Savings Association
231 South LaSalle Street
Chicago, Illinois 60697

JAMES D. HOLZHAUER
Counsel of Record
TIMOTHY S. BISHOP
JEFFREY W. SARLES
Mayer, Brown & Platt
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

Counsel for Petitioner

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QUESTIONS PRESENTED

1. Whether a court reviewing an arbitration award under the Federal Arbitration Act should apply a *de novo* standard of review or the more deferential standard applied to arbitrators' decisions on the merits when reviewing the arbitrators' decision on arbitrability where the party objecting to arbitral jurisdiction had submitted the issue to the arbitrators for decision, as to which the courts of appeal are in conflict.

2. Whether the United States Courts of Appeals should apply a *de novo* or an abuse-of-discretion standard of appellate review to a district court's decision denying a petition to vacate an arbitration award and granting a cross-petition to confirm an award, as to which the courts of appeal are in conflict.

RULE 29.1 STATEMENT

Petitioner First Options of Chicago, Inc., is wholly owned by SLK Acquisition Co., which is in turn wholly owned by SLK Holdings, Inc. SLK Holdings is wholly owned by Spear, Leeds & Kellogg, a limited partnership. First Options has no non-wholly owned subsidiaries.

At the time this case arose, First Options was owned by Continental Bank, N.A.; Continental Bank retained its interest in this case when it sold First Options in 1991. In 1994, Continental Bank became part of Bank of America National Trust & Savings Association ("Bank of America"), the corporate parent of which is BankAmerica Corporation. Bank of America has one subsidiary that is not wholly owned by Bank of America affiliates, which is Ontario Limited.

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A53) is reported at 19 F.3d 1503. The opinion of the district court (Pet. App. C1-C32) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 31, 1994. A timely petition for rehearing was denied on June 29, 1994. The petition for a writ of certiorari was filed on September 27, 1994, and was granted on December 5, 1994. The jurisdiction of this Court rests on 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, are set forth in a statutory appendix to this brief, at 1a-5a.

STATEMENT

1. The Parties and their Market-Maker Agreement

Petitioner First Options of Chicago, Inc. ("First Options") is a clearing member of the Philadelphia Stock Exchange (the "Exchange") and of other securities and commodities exchanges. As a clearing firm, First Options provides administrative support and risk control services to customers who open trading accounts with the company. First Options has considerable financial exposure in the event its customers incur losses because it guarantees to the Exchange and to persons with whom its customers trade that its customers' positions will be covered. Pet. App. A4-A5.

Respondent MKI Investments, Inc. ("MKI") was one of First Options' customers. MKI was a member of the Exchange and an "options market maker," trading options

for its own account. It was controlled by respondent Manuel Kaplan, who was president, a director, and sole shareholder of the company. Mr. Kaplan was also a member of the Exchange in his own right until December 1987. Carol Kaplan is Manuel Kaplan's wife. Pet. App. A4-A5, C4.

MKI's relationship with First Options was governed by a 1984 Market-Maker Agreement, in which First Options agreed to clear MKI's trading account and MKI agreed to repay any deficiency in that account. The agreement protected First Options by providing that the company had the right to liquidate MKI's positions "whenever in [First Options'] discretion [First Options] deem[ed] it necessary." The Market-Maker Agreement also provided that "any controversy * * * arising out of [MKI's] business or this agreement" was to "be submitted to and determined by arbitration." Pet. App. A4-A5.

2. The October 1987 Stock Market Crash and its Aftermath

In mid-October 1987, MKI's trading account with First Options had an approximately $10.5 million credit balance. Then, on October 19, 1987, the stock market plummeted. By the end of the trading day MKI's account showed a deficit of $2.1 million. Because First Options guaranteed all positions in MKI's accounts, First Options was at risk on the full amount of that deficit and any subsequent losses. Pet. App. A5.

Although MKI faced significant risk of further losses in its account, Mr. Kaplan refused to cooperate with First Options in reducing that risk. Instead, he barricaded himself in MKI's offices and declined to communicate with First Options' staff. Pet. App. C3. First Options therefore exercised its right under the Market-Maker Agreement to take control of MKI's account and to liquidate positions in the account that it deemed to pose unacceptable risks. As a

result of First Options' liquidation of MKI's positions, the account deficit increased to some $5.1 million. A deficit in another account and unpaid brokerage fees brought MKI's total indebtedness to First Options to $6,227,188. *Id.* at A6-A7, C3. This debt left MKI insolvent. *Id.* at A51, C29.

Unbeknownst to First Options, MKI nevertheless had substantial cash in a bank account controlled by Mr. Kaplan. Instead of using this cash to repay MKI's creditors, Mr. Kaplan withdrew $611,300 between October 19 and December 18, 1987. Pet. App. A51, C29; C.A. App. A972. Mr. Kaplan made these withdrawals, First Options' accounting expert testified before the arbitrators, at a time when he owed MKI about $2.2 million for outstanding loans he had taken from the corporation. C.A. App. A1068-A1069. There was thus evidence, as the district court noted, "that Mr. Kaplan disregarded corporate formalities and siphoned corporate funds." Pet. App. C29; see also *id.* at C28-C29 (discussing evidence that Mr. Kaplan commingled MKI's funds with his own).

3. The Workout Agreement

Unaware of MKI's cash reserves, of Manuel Kaplan's withdrawals of funds, or of the financial position of Kaplan and his company, First Options negotiated a workout to try to secure repayment of the nearly $6.25 million it was owed. On March 24, 1988, First Options, MKI, Manuel Kaplan, and Carol Kaplan agreed on the terms of a workout, executing a Letter Agreement (signed by all four parties), a Guaranty (obligating MKI), a Subordinated Loan Agreement (executed by First Options and MKI), and a Subordinated Promissory Note (executed by MKI) (together, the "Workout Agreement"). The Subordinated Loan Agreement contained a broad arbitration clause that on its face applied to the Letter Agreement signed by the Kaplans (Pet. App. C12):

> any controversy arising out of or relating to this Agreement, the Letter Agreement, the Subordinated Notes or any other document referred to herein or therein or the breach thereof shall be submitted to and settled by arbitration pursuant to the Constitution and Rules of the Exchange. The parties hereto and all who may claim under them shall be conclusively bound by such arbitration.

Under the terms of the Workout Agreement MKI agreed to repay its $6.25 million debt to First Options; MKI transferred four Exchange memberships to First Options; MKI and Mr. Kaplan contributed $900,000 to a new trading account, which MKI resumed trading; Mr. Kaplan paid First Options $80,000; Mr. and Mrs. Kaplan agreed to remit to First Options their 1987 tax refund, estimated to exceed $300,000; and MKI agreed to split its trading profits with First Options. Pet. App. A7-A8.[1]

Pursuant to the Workout Agreement, MKI resumed trading in April 1988. Its account soon sustained additional substantial losses. On January 16, 1989, MKI lost $1.5 million on its "short call" positions in the options of a single stock. First Options requested that MKI act to reduce risk in its account, but Mr. Kaplan failed to do so and was unresponsive to First Options' concerns. First Options therefore once again took control of MKI's account and liquidated the positions in the account, leaving an additional deficit of $65,000. Pet. App. A8-A9, C4-C5. After Mr.

[1] Mr. Kaplan represented that he had borrowed $500,000 of the $900,000 contributed to MKI's new trading account, which had the effect under the Workout Agreement of according the lenders priority over First Options in their claim to MKI's equity. In fact, the evidence proved that Mr. Kaplan provided these funds himself. Pet. App. A49, C30; J.A. 7-8.

Kaplan refused to allow First Options to inspect MKI's books or the Kaplans' tax returns, or to pay First Options the Kaplans' 1987 tax refund, First Options declared an acceleration of the debt and demanded repayment of the entire amount due under the Workout Agreement. *Id.* at A9. When this demand, too, went unsatisfied, First Options submitted its claim to the Exchange for arbitration.

4. The Arbitration Proceeding

On July 1, 1989, First Options filed a Statement of Claim with the Exchange alleging that respondents had violated the Workout Agreement. First Options' claim sought damages in excess of $300,000 against the Kaplans for failure to remit their 1987 tax refund to First Options. It also requested damages of nearly $6.3 million against MKI, as well as against Manuel Kaplan personally. First Options alleged that Manuel Kaplan was individually liable for MKI's debt because (i) Kaplan was the controlling person of MKI and all MKI's activities were for his benefit, and (ii) MKI was Kaplan's alter ego and instrumentality. First Options' grounds for asking the arbitration panel to pierce MKI's corporate veil to award damages against Mr. Kaplan were that Kaplan had inadequately capitalized the company, had disregarded corporate formalities, and had treated MKI's assets as his own. Pet. App. A10, C5; C.A. App. A62-A71.

MKI and First Options thereafter signed an agreement, separate from the arbitration clause in the Subordinated Loan Agreement, submitting the case to the Exchange for arbitration. The Kaplans did not sign a submission agreement. Pet. App. A10. First Options believed that the Exchange nevertheless had jurisdiction over the Kaplans on four distinct grounds. *Id.* at A23-24, A43, C12-13. First, for the same reasons that MKI was the alter ego of Mr. Kaplan, rendering him liable for MKI's violation of the Workout Agreement, Mr. Kaplan also was subject to jurisdiction of the Exchange

through MKI. Second, the Kaplans were bound by the arbitration clause in the Subordinated Loan Agreement because that provision was an integral part of the Workout Agreement and was to be read together with the Letter Agreement to which it expressly referred and which the Kaplans had both signed. Third, Manuel Kaplan was an "associated person" of MKI as defined in the Securities and Exchange Act of 1934, 15 U.S.C. § 78c(a)(21), and as such was subject to Exchange jurisdiction under Exchange Rule 950, section 6(a)(2), which provides that "[a]ny dispute, claim or controversy * * * between and/or among members and/or associated persons * * * shall be arbitrated under these procedures." C.A. App. A289. Finally, the Exchange could exercise jurisdiction over Mr. Kaplan under Exchange Rule 950, section 6(a)(1), because he had been a member of the Exchange at the time of the stock market crash that necessitated the workout. *Ibid.*

The Kaplans filed objections to the Exchange's jurisdiction. At the same time, they answered First Options' claims, addressing the merits and denying liability. Mr. Kaplan also filed a counterclaim against First Options with the Exchange, seeking $10 million damages for interference with prospective business opportunities and libel and slander. Mr. Kaplan's counterclaim did not question the arbitrators' jurisdiction. Pet. App. A10-A11; C.A. App. A119-171. Subsequently, at the beginning of a pre-hearing discovery conference before the Exchange Arbitration Committee on February 26, 1990, the Kaplans withdrew their jurisdictional objections. Thereafter, they fully participated in the conference. Pet. App. A11, C15-16; C.A. App. A191.

For the next two years the case lay largely dormant. In January 1992, however, after they retained new counsel, the Kaplans filed a Motion to Dismiss for Lack of Jurisdiction and a supporting memorandum with the arbitration panel, claiming to "reiterate and renew" the objections that had

earlier been withdrawn and denying each of the four grounds of arbitral jurisdiction asserted by First Options. The Kaplans made this motion without reservation; nowhere in it did they claim that the arbitration panel should not decide the issue of its jurisdiction, or assert that jurisdiction should be ruled upon by a court in the first instance. C.A. App. A194-A205. Nor did the Kaplans decline to go ahead with the arbitration, or seek relief from the courts to prevent the arbitration from taking place. In an order dated January 14, 1992, the arbitration panel denied the Kaplans' Motion to Dismiss for Lack of Jurisdiction. Pet. App. A12; J.A. 39.

After the Kaplans' jurisdictional objections were rejected, the parties' claims and counterclaims proceeded to an eight-day, nineteen-witness evidentiary hearing before the arbitration panel. The panel rendered an award in favor of First Options on both the claims and counterclaims. The award noted First Options' contention that Manuel Kaplan "is the alter ego of MK Investments, Inc. on the basis of Mr. Kaplan's failure to maintain a separate corporate existence and fraud," and required MKI and Manuel Kaplan, jointly and severally, to pay First Options $5,662,188 plus interest. The arbitrators also found that Manuel and Carol Kaplan were liable under the Letter Agreement to remit their 1987 tax refund to First Options, and required the Kaplans, jointly and severally, to pay First Options $346,342 plus interest. Pet. App. A12; J.A. 40-43.

5. The District Court's Confirmation of the Arbitration Award

Respondents filed a petition to vacate the arbitrators' award in the district court pursuant to Federal Arbitration Act section 10 (9 U.S.C. § 10); First Options cross-petitioned to confirm the award under section 9 of the Act. In their petition, the Kaplans challenged the arbitrators' determination of jurisdiction. They argued that First Options' claims

against them were not properly arbitrable, that the panel had "exceeded its powers" when it took jurisdiction over them, and that the court should therefore vacate the award under Arbitration Act section 10(a)(4). Manuel Kaplan also argued that the panel had acted in manifest disregard of law when it determined that he was jointly and severally liable with MKI for violation of the Workout Agreement. The district court rejected these arguments and confirmed the award. Pet. App. C9-C18, C27-C30.

Stating that "[i]t is well-established that a party who voluntarily and unreservedly submits an issue to arbitration cannot later maintain that the arbitrators acted without authority to resolve that issue," the district court held that the Kaplans had waived their jurisdictional objections. Pet. App. C14. Rather than "consistently maintain[ing] an objection to the arbitration panel's jurisdiction," the Kaplans had filed a motion expressly asking the arbitration panel to decide the issue of jurisdiction and "expressed no unwillingness to abide by the arbitrators' decision." *Id.* at C17. Manuel Kaplan, moreover, filed counterclaims invoking the panel's jurisdiction. These actions, the court held, "manifest[ed] a clear acceptance of the arbitration panel's authority" to decide the question of arbitrability. *Id.* at C18. In those circumstances, the district court recognized, its power to review the arbitrators' award was "'severely limited'" (*id.* at C6): "Where a party has waived jurisdictional objections" by submitting the issue of arbitrability to the arbitration panel for decision, "the court reviews a decision to exercise jurisdiction like any other arbitration decision only for a manifest disregard of law." *Id.* at C18.

Reviewing the arbitration record, the district court then concluded that the arbitration panel's jurisdictional determination had not been in manifest disregard of law. To begin with, and "even under a *de novo* review" (Pet. App. C18),

the panel had jurisdiction over the Kaplans by the terms of the Workout Agreement:

> The Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties. In view of this and the well-established federal policy favoring arbitration * * *, the court concludes that pursuant to the arbitration provision in the subordinated loan document, the arbitration panel had jurisdiction over the Kaplans.

Id. at C13-C14. In addition, it was not "completely irrational" or an "obvious" error "capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator" for the panel to have pierced the corporate veil to reach Manuel Kaplan individually. *Id.* at C27. The arbitrators, the court emphasized, "heard considerable testimony regarding the commingling of Mr. Kaplan's personal funds with those of MKI," together with "evidence that Mr. Kaplan disregarded corporate formalities and siphoned corporate funds." *Id.* at C28-C29. There was thus "ample support in the record for the arbitrators' decision to pierce the corporate veil." *Id.* at C30.

6. The Third Circuit's *De Novo* Review of the Arbitration Award

The Third Circuit reversed the order of the district court confirming the arbitration award against the Kaplans on the basis that the arbitration panel lacked jurisdiction. No deference was due the arbitrators' ruling on arbitrability, the court held, even though the Kaplans had submitted that issue to the arbitration panel for decision in the first instance. Thus, the district court should have "independently decide[d] whether [the] arbitration panel ha[d] jurisdiction over the

merits of [the] dispute." Pet. App. A14. Likewise, the court of appeals' own review of the district court's denial of the Kaplans' motion to vacate the arbitral award for lack of jurisdiction was plenary. *Id.* at A13. Having so held, the court then engaged in a lengthy *de novo* review of the evidence presented to the arbitrators, concluding that Manuel and Carol Kaplan had never waived their jurisdictional objections and had not agreed to arbitration in the Workout Agreement, and that Manuel Kaplan was not subject to Exchange jurisdiction as a member, as an "associated person," or under an alter ego theory. *Id.* at A17-A53.

SUMMARY OF ARGUMENT

A party resisting arbitration may obtain an advance judicial determination of whether the dispute is arbitrable. But that party may instead take advantage of the relative simplicity, efficiency and finality of arbitration by submitting the arbitrability question to the arbitrator. That is precisely what the respondents did in this case. In those circumstances, as the decisions of this Court, the provisions of the Federal Arbitration Act, and the holdings of several courts of appeals make clear, courts should defer to the arbitral decision on arbitrability just as they defer to arbitration decisions on the merits. The Third Circuit's approach in this case—requiring *de novo* review by the district court and once again by the court of appeals—cannot be reconciled with the provisions of the Federal Arbitration Act or with the federal policy favoring arbitration.

1. This Court has consistently recognized that absent an agreement to arbitrate, parties cannot be compelled to submit disputes to arbitration. Accordingly, parties may obtain advance judicial determinations of whether disputes are arbitrable. But they may also submit the arbitrability question to the arbitrator, and if they do so the arbitrator's

decision is entitled to the same high degree of deference as an arbitral decision on the merits.

The Federal Arbitration Act establishes the mechanics by which parties can obtain advance judicial rulings on arbitrability. Section 3 of the Act requires the courts to stay proceedings that are subject to arbitration, and section 4 permits a party to bring an action to compel arbitration. In addition, a party resisting arbitration may seek an injunction or a declaratory judgment that a dispute is not arbitrable. The parties may also submit the arbitrability issue to the arbitrator, however. If they do so, the arbitrator's decision on that issue cannot be set aside unless it was made "in manifest disregard of the law." That standard is an extraordinarily deferential one. Arbitration awards cannot be overturned on the basis of "mere error" or even "serious error"; they must be upheld unless they are "completely irrational" or so arbitrary that "a ground for the arbitrator's decision cannot be inferred from the facts of the case." See pages 21-23, *infra*.

Highly deferential review of arbitral awards on issues submitted to arbitration by the parties is essential to serve the goals of the Federal Arbitration Act: "enforcement of private agreements and encouragement of efficient and speedy dispute resolution." *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 221 (1985). The Third Circuit's approach encourages wasteful, strategic behavior. It permits a party to litigate the arbitrability issue (and the merits of the dispute) before the arbitrator, and then (if that party is unsuccessful) to fully relitigate the arbitrability issue in the district court and again in the court of appeals. That approach—giving the party resisting arbitration *three* bites of the apple—is contrary to the purposes of the Arbitration Act, would increase the workload of the courts, and would frustrate the intent of the parties who agreed in advance to an efficient and conclusive means of dispute resolution. It is not

at all surprising that other courts of appeals have rejected the Third Circuit's approach and have held that once the parties submit the question of arbitrability to the arbitrator, the arbitral determination of that issue is entitled to great deference.

In this case, respondents raised their jurisdictional objections at the outset. They also denied First Options' claims and asserted a $10 million counterclaim on behalf of Manuel Kaplan. Respondents subsequently withdrew their objections. Then, on the eve of arbitration nearly two years later, respondents reasserted their objections. At that point, rather than seek a judicial determination of arbitrability, respondents submitted that issue to the arbitration panel. In these circumstances, the arbitration panel's fact-bound decision denying respondents' jurisdictional challenge is entitled to deference.

2. The Third Circuit also ruled that in reviewing the district court's decision, it would "stand in the shoes" of that court and once again consider the arbitrability issue *de novo*. The court of appeals should instead have applied a deferential "abuse of discretion" standard, which the Eleventh Circuit has held best reflects the strong federal policy favoring arbitration. In the alternative, the court of appeals should at the very least have applied the usual standards of appellate review. Either standard of review should have led the court to defer to the arbitration award, because it was not made "in manifest disregard of the law."

ARGUMENT

I. WHEN PARTIES SUBMIT THE ISSUE OF ARBITRABILITY TO THE ARBITRATOR IN THE FIRST INSTANCE, THE ARBITRATOR'S DETERMINATION IS ENTITLED TO DEFERENCE

It is well-settled that ordinarily it is "for the court, not the arbitrator, to decide in the first instance whether [a] dispute [is] to be resolved through arbitration" or whether it lies outside the arbitrator's jurisdiction. *AT&T Technologies, Inc.* v. *Communications Workers of America*, 475 U.S. 643, 651 (1986). Parties to an arbitration agreement have the opportunity to obtain an advance judicial determination of whether a dispute is arbitrable, this Court has explained, because arbitration "'is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *Id.* at 648. First Options does not challenge these basic principles.

This Court's precedents make equally clear, however, that "the parties [may] exclud[e] from court determination not merely the decision of the merits of [a dispute] but also the question of its arbitrability, vesting power to make both decisions in the arbitrator." *United Steelworkers* v. *Warrior & Gulf Nav. Co.*, 363 U.S. 574, 583 n.7 (1960). The text, structure, and history of the Federal Arbitration Act demonstrate, as many courts of appeals and commentators have recognized, that when the parties choose to submit the issue of jurisdiction to the arbitrator in the first instance instead of using one of the methods provided in the Act to secure an initial court ruling on that question, the arbitrator's decision as to jurisdiction is properly accorded the same deference as the arbitrator's decision on the merits.

This approach best effectuates the important federal policies favoring arbitration and freedom of contract. It promotes the efficient and economical use of arbitral and judicial

resources, allowing parties to have all issues decided by an arbitrator without diminishing their right to an advance judicial determination of arbitrability if they would rather take that course. But it does not permit a party to take repeated bites of the apple, fully litigating arbitrability before the arbitration panel and then fully relitigating that issue in the courts.

A. This Court's Precedents Establish That Parties May Submit The Issue Of Arbitral Jurisdiction To The Arbitrator, In Which Case Judicial Review Is Highly Deferential

The scope of an arbitrator's powers is defined by agreement between the parties; a party "cannot be compelled to arbitrate [a dispute] if an arbitration clause does not bind it" to do so. *John Wiley & Sons, Inc.* v. *Livingston*, 376 U.S. 543, 547 (1964). To ensure that a party is not "required to submit to arbitration any dispute which he has not agreed so to submit," this Court has recognized that a party may obtain an initial ruling from the courts on the question whether a contract provides for arbitration of the particular dispute in issue. *Warrior & Gulf Nav. Co.*, 363 U.S. at 582; see also *Atkinson* v. *Sinclair Refining Corp.*, 370 U.S. 238, 241 (1962).

While it is clear that a party cannot be *compelled* to arbitrate a dispute prior to a judicial determination that the dispute is arbitrable, there also is no doubt that parties may elect to submit the issue of arbitrability to the arbitrator in the first instance. At the core of federal laws governing arbitration, including the Federal Arbitration Act, is the principle of freedom of contract. See *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 220 (1985) (the Arbitration Act manifested "congressional desire to enforce agreements into which parties had entered"); *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985)

("The 'liberal federal policy favoring arbitration agreements' * * * is at bottom a policy guaranteeing the enforcement of private contractual arrangements"). Consistent with that principle, this Court has made it clear that if parties authorize the arbitrator to decide arbitrability, the courts must give effect to that decision.

Thus, in *AT&T Technologies*, a union challenging an employer's layoff decision wanted to arbitrate that dispute. After the employer refused, saying that the issue was not arbitrable, the union filed suit to compel arbitration. The lower courts held that the arbitrability issue (along with the merits of the dispute) should be submitted to the arbitrator. Reversing, this Court held that "the question of arbitrability * * * is undeniably an issue for judicial determination. *Unless the parties clearly and unmistakably provide otherwise*, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." 475 U.S. at 649 (emphasis added). In *AT&T Technologies* there was no indication that the union had submitted the jurisdictional issue to the arbitrator. To the contrary, the union had moved the court to rule on that issue in the first instance when it sought to compel arbitration.

In this case, by contrast, respondents submitted the issue of arbitrability to the arbitrator for decision in the first instance by filing a motion to dismiss for lack of jurisdiction and a supporting memorandum with the arbitration panel. In submitting arbitrability to the arbitrator in this way, a party "clearly and unmistakably provide[s]" that arbitrability is an issue for the arbitrator rather than the court. The arbitrator's determination of the scope of arbitral jurisdiction becomes "a matter of consent, not coercion" and hence is "give[n] effect" by the court on the same terms as the other "contractual rights and expectations of the parties." *Volt Info. Sciences, Inc.* v. *Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989). Implicit in the parties'

choice is an acknowledgment that the same "efficient and speedy [system of] dispute resolution" will govern the jurisdictional issue as governs the merits (*Dean Witter Reynolds*, 470 U.S. at 221), including the same "limited role" for a court "asked to review the decision of [the] arbitrator." *United Paperworkers Int'l Union* v. *Misco, Inc.*, 484 U.S. 29, 36 (1987).

For more than a century, this Court has recognized that "[t]he law implies an agreement to abide the result of an arbitration from the fact of submission" to the arbitrator—without distinguishing between submission of the merits alone and submission, in addition, of the question of arbitrability. *Smith* v. *Morse*, 76 U.S. 76, 82 (1869). Once jurisdiction or any other contractual issue is submitted to the arbitrator, this Court has held, the arbitrator's decision on that issue will not be vacated even for serious "factual or legal error," but only for the most obvious and egregious violations of the basic rules of decisionmaking, amounting to "manifest disregard" of the law. *Misco*, 484 U.S. at 38; *Wilko* v. *Swan*, 346 U.S. 427, 436 (1953) (overruled on other grounds in *Rodriguez de Quijas* v. *Shearson/American Express, Inc.*, 490 U.S. 477 (1989)). See also R. Gorman, *Basic Text on Labor Law* 587 (1976) (The "issue of substantive arbitrability may itself be given by the parties to the arbitrator for resolution. * * * In such a case, * * * [t]he usual narrow standard of judicial review * * * should apply").

As a general matter, this Court has frequently explained that courts have an extremely limited role in reviewing arbitration decisions. "The courts are not authorized to reconsider the merits of an award even though the parties may allege that the award rests on errors of fact or on misinterpretation of the contract." *Misco*, 484 U.S. at 36. See also *AT&T Technologies*, 475 U.S. at 649-650; *United Steelworkers* v. *American Mfg. Co.*, 363 U.S. 564, 567-568 (1960).

The Third Circuit erred when it ignored these general arbitration principles in this case. Although they have been stated most frequently in labor cases, these principles are equally applicable to arbitration of other kinds of disputes under the Federal Arbitration Act. See *Misco*, 484 U.S. at 40 n.9 (noting that "the federal courts have often looked to the [Federal Arbitration] Act for guidance in labor arbitration cases"). The architecture of the Arbitration Act leaves no doubt that, contrary to the Third Circuit's ruling, judicial review of a jurisdictional issue submitted by the parties to the arbitrator is to be as narrowly circumscribed as review of the arbitrator's decision on the substance of the dispute.

B. When Parties Submit Arbitrability To The Arbitrator, The Federal Arbitration Act Requires Deferential Judicial Review Of That Issue

The Federal Arbitration Act "sets out a comprehensive plan for arbitration of controversies coming under its terms." *Commonwealth Coatings Corp.* v. *Continental Cas. Co.*, 393 U.S. 145, 146-147 (1968). The Act permits parties to obtain advance judicial determinations of arbitrability, and also permits parties to submit all of the issues in dispute—including arbitrability—to the arbitrator. Once an issue is decided through arbitration, the Act severely limits judicial review. Deference to arbitral decisions on arbitrability is every bit as essential to the proper operation of the federal arbitration scheme as deference to decisions on other issues submitted to the arbitrator.

1. The Federal Arbitration Act gives parties the option to obtain an advance judicial determination of arbitrability or to submit that issue to the arbitrator

At the heart of the Arbitration Act's "body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate" lie two sections designed to enable a party to obtain an advance judicial ruling whether a dispute is subject to arbitration. *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32 (1983). Section 3 of the Act (9 U.S.C. § 3) provides that a party to litigation in federal court may obtain a stay of the court proceeding if the dispute is properly referable to arbitration. Section 4 requires federal courts, on the petition of a party to an agreement providing for arbitration of disputes, to compel arbitration of such a dispute. See *Prima Paints Corp.* v. *Flood & Conklin Mfg.*, 388 U.S. 395, 400 (1967) ("Section 4 provides a federal remedy for a party 'aggrieved by [failure to arbitrate]' and directs the federal court to order arbitration once it is satisfied that an agreement for arbitration has been made and has not been honored").

Congress designed these two provisions with the "clear intent * * * to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone Mem. Hosp.*, 460 U.S. at 22. In keeping with this goal, both sections "call for an expeditious and summary hearing, with only restricted inquiry into factual issues." *Ibid.*; see also 9 U.S.C. § 6 (providing that applications to enforce arbitration agreements are generally governed by the rules relating to motion practice); H. R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924).

The Arbitration Act thus provides a clear mechanism for a party that objects to arbitration on jurisdictional grounds to obtain a judicial ruling on arbitrability in the first instance.

"Arbitration cannot go ahead without either the resisting party's cooperation or judicial intervention," so the opportunity to defend against a section 3 or section 4 application is "all the judicial protection the resisting party needs." 2 I. MacNeil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* 23:24 (1994). In the event that the arbitration agreement provides for arbitral default awards, however, a party refusing to participate in arbitration may run the risk of default if the other party pursues arbitration without first filing an application under sections 3 or 4. It is well established that in those circumstances—and whenever a party wishes to take affirmative action to establish that an issue is not arbitrable—a party may file an independent action (or a motion in pending litigation) seeking an injunction or a declaratory judgment to prevent arbitration from going forward. *Id.* at 23:25-23:26. See, *e.g.*, *Comprehensive Accounting Corp.* v. *Rudell*, 760 F.2d 138, 139-140 (7th Cir. 1985); *George Day Constr. Co.* v. *United Bhd. of Carpenters and Joiners, Local 354*, 722 F.2d 1471, 1476 (9th Cir. 1984).[2]

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[2] The procedures set out in sections 3 and 4 of the Arbitration Act, as well as independent actions for declaratory or injunctive relief, enable parties resisting arbitration to obtain a judicial ruling on arbitrability *before* the arbitration takes place. In *George Day*, the Ninth Circuit held that a party may also be able to reserve the jurisdictional issue for court decision during post-arbitration proceedings to enforce or vacate the arbitral award "by simply not giving the arbitrability question to the arbitrator for decision," but instead expressly "reserving that question for later judicial determination." 722 F.2d at 1476. By *not* presenting the arbitrability question to the arbitrator, the court of appeals reasoned, "the question could be preserved for an independent judicial scrutiny at any subsequent proceeding for vacatur or enforcement." *Ibid.* That possibility is not raised in this case.

(continued...)

In these ways, the Arbitration Act provides ample opportunity for a party to obtain an advance judicial ruling on arbitrability. But that is not the only option: a party can forego those opportunities and instead present the arbitrability issue to the arbitrator for decision—as respondents did in this case. The choice to forego an initial judicial determination of arbitrability can be manifested by express agreement or by the act of submitting the jurisdictional dispute to the arbitrator. When parties to an arbitration agreement "argue the issue [of jurisdiction] to the arbitrator," then "[b]y their conduct" they "gran[t] the arbitrator the jurisdiction to decide their arbitrability question and 'in effect empowe[r] him to decide' those issues." *Franklin Electric Co.* v. *UAW Local 1000*, 886 F.2d 188, 192 (8th Cir. 1989); see also P. Hoblin, *Securities Arbitration* 10-9 to 10-10 (2d ed. 1992). In those circumstances, the parties have "clearly and unmistakably provide[d]" for arbitration of the arbitrability issue. *AT&T Technologies*, 475 U.S. at 649.

2. The Federal Arbitration Act requires courts to defer to arbitral decisions on issues the parties submit to the arbitrator

Once an arbitral award has been entered, a party may move the court to confirm that award (9 U.S.C. § 9), to vacate it (§ 10), or to correct or modify ministerial errors in the award. § 11. Under section 9, the court must confirm the award unless the grounds for vacation set out in section 10 are satisfied. Those grounds are very narrow: fraud in the procurement of the award (§ 10(a)(1)), serious procedural

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[2](...continued)
Far from reserving arbitrability for the court by not submitting that issue to arbitration, respondents filed a motion to dismiss and a supporting memorandum with the arbitration panel specifically requesting that it decide whether it had jurisdiction.

due process violations such as bias or improper exclusion of material evidence (§ 10(a)(2) & (3)), and "[w]here the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." § 10(a)(4).

The standard that must be applied by a district court in reviewing an arbitrator's decision regarding issues submitted by the parties is extremely deferential. *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 232 (1987) ("judicial scrutiny of arbitration awards necessarily is limited"). That standard has been described in a number of different ways. Following *Wilko*, 346 U.S. at 436-437, most courts (including the district court in this case, Pet. App. C18) have held that an arbitrator's decision may not be vacated unless it was made in "manifest disregard of law." Courts of appeals have variously described this standard as "a sort of 'abuse of discretion' standard" (*Jenkins* v. *Prudential-Bache Sec., Inc.*, 847 F.2d 631, 634 (10th Cir. 1988)), as requiring "something beyond and different from a mere error in the law" (*Siegel* v. *Titan Indus. Corp.*, 779 F.2d 891, 892 (2d Cir. 1985)), and as applying where "the arbitrator 'understood and correctly stated the law but proceeded to ignore it.'" *Id.* at 893. Others have asked whether the arbitrator's decision was "completely irrational" (*French* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 784 F.2d 902, 906 (9th Cir. 1986)), or was "arbitrary and capricious" such that "'a ground for the arbitrator's decision cannot be inferred from the facts of the case.'" *Raiford* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 1410, 1413 (11th Cir. 1990).

As the First Circuit has remarked, these different formulations—which almost invariably result in confirmation of an arbitrator's award—are essentially "identical." *Advest, Inc.* v. *McCarthy*, 914 F.2d 6, 9 (1st Cir. 1990). Unless the arbitrator's award is extraordinarily and obviously misguid-

ed—so extreme as clearly not to constitute an interpretation of the contract at all—it must be afforded deference by the district court. See *Misco*, 484 U.S. at 40 n.9 ("as long as the arbitrator is even arguably construing the contract * * *, that a court is convinced he committed serious error does not suffice to overturn his decision"); Cohen & Dayton, *The New Federal Arbitration Law*, 12 Va. L. Rev. 265, 272-273 (1926) ("The courts are bound to accept and enforce the award of the arbitrators unless there is in it a defect so inherently vicious that, as a matter of common morality, it ought not to be enforced").[3]

Any more stringent standard of review would interfere with the "statutory policy of rapid and unobstructed enforcement of arbitration agreements." *Moses H. Cone Mem. Hosp.*, 460 U.S. at 23. "[A]n extremely low standard of review" is essential if arbitration is not to become "merely

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[3] To make arbitration less costly and time-consuming and less subject to second-guessing, arbitrators commonly make their award "without explanation of their reasons" (*Wilko*, 346 U.S. at 436), as the panel did in this case when it denied respondents' motion to dismiss for lack of jurisdiction. See generally 3 I. MacNeil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* 37:15; A. Djinis & J. Post, *Securities Arbitration* § 10.02[4] (1991). Absent reasoning for an arbitral decision, a party seeking to vacate an award will be "hard pressed to satisfy the exacting criteria for invocation of the ['manifest disregard'] doctrine." *Advest*, 914 F.2d at 10; see also *A.G. Edwards & Sons* v. *McCollough*, 967 F.2d 1401, 1403 (9th Cir. 1992) ("The rule that arbitrators need not state their reasons presumes the arbitrators took a permissible route to the award where one exists"), cert. denied, 113 S. Ct. 970 (1993); C. Fletcher, *Arbitrating Securities Disputes* 387 (1990) (because "arbitrators do not normally issue opinions, it is difficult to tell whether they ignored the law"). Of course, parties are free to agree in advance that an arbitral award is to be supported by a statement of reasons.

an added preliminary step to judicial resolution rather than a true alternative." *E.I. DuPont de Nemours* v. *Grasselli Employees Indep. Ass'n*, 790 F.2d 611, 614 (7th Cir.), cert. denied, 479 U.S. 853 (1986).

Applying the correct deferential standard to the issue of arbitrability, if the parties submit that issue to arbitration in the first instance, the arbitrator's determination cannot be overturned unless it is so defective that it reflects a manifest disregard of the law. See *Wilko*, 346 U.S. at 436-437; *Ferndale Corp.* v. *Schulman Urban Dev. Assocs.*, 758 F. Supp. 861, 867-869 (S.D.N.Y. 1990) (under New York law, a party objecting to arbitral jurisdiction should make advance application to the court for a stay; if it fails to do so, its "remedy is to seek to vacate * * * the award" on the grounds set out in the statute, which parallel those listed in Federal Arbitration Act § 10 and which do not include "[t]he absence of an agreement to arbitrate"). The Third Circuit erred when, far from requiring substantial deference to the arbitrators in this case, it reviewed the question whether the arbitration panel had jurisdiction over First Options' claims against the Kaplans *de novo*. Pet. App. A14.

3. Giving effect to the parties' decision to submit the jurisdictional issue to the arbitrator best serves the goals of the Federal Arbitration Act

As we demonstrate above, the Federal Arbitration Act provides that the issue of arbitrability may be presented to the court in the first instance through section 3 and section 4 motions or independent actions for injunctive or declaratory relief. Alternatively, arbitrability may be presented to the arbitrator in the first instance, in which case the arbitrator's decisions as to jurisdiction and the merits receive the same high degree of deference when they are reviewed by the court in a proceeding brought under sections 9 or 10 of the Act. Giving deference to the arbitrator's jurisdictional

decision best reflects Congress' goals in enacting the Arbitration Act, which were "enforcement of private agreements and encouragement of efficient and speedy dispute resolution." *Dean Witter Reynolds*, 470 U.S. at 221. See, *e.g.*, *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-511 (1974) (the Act was designed "to place arbitration agreements 'upon the same footing as other contracts'" and "to allow parties to avoid 'the costliness and delays of litigation'").

The congressional goal of ensuring that private arbitration agreements are legally effective suggests that parties should have "the right to dispose of any controversy which may arise out of the contract in their own fashion," including the right to consent to have arbitrability decided by the arbitrator. *Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. on the Judiciary*, 68th Cong., 1st Sess. 14 (1924) (testimony of Julius Henry Cohen, a principal drafter of the Act). The parties certainly may stipulate in their formal agreement to arbitrate that matters of jurisdiction will be settled by the arbitrator. *Warrior & Gulf Nav. Co.*, 363 U.S. at 583 n.7. But courts also give effect to private arbitration agreements when they defer to a jurisdictional determination that a party *asked* the arbitrator to make.

The other principal goal of the Federal Arbitration Act—to allow parties to settle disputes by a less formal, more accelerated, and less costly method than litigation—is likewise much better served by giving full effect to the parties' decision to submit the arbitrability issue to the arbitrator. The Arbitration Act allows parties to make a trade-off, securing "prompt, economical and adequate solution of controversies though arbitration" in exchange for the procedural protections (including appellate review) and the presumed greater likelihood of "legally correct adjustment" available in the courts. *Wilko*, 346 U.S. at 438. See Ware, *Punitive Damages in Arbitration: Contracting Out of Government's Role in Punishment and Federal Preemption of*

State Law, 63 Fordham L. Rev. 529, 542 n.50 (1994) ("In agreeing to arbitrate, parties trade their substantive rights for the arbitrator's decision as constrained by the agreement and the limited judicial review of arbitral awards").

The Third Circuit's approach requires no such trade-off. Rather, it encourages a party to present its case on arbitrability and on the merits to the arbitrator, secure in the knowledge that if it loses it can reopen the arbitrability issue for *de novo* review by the court. To authorize a party to "preserv[e] for itself two bites at the apple" in this way is perversely contrary to the aim of sections 3, 4, and 10 of the Act, which is precisely to ensure that issues are fully litigated only in *one* forum. 2 I. MacNeil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* at 17:44; see also *Halley Optical Corp.* v. *Jagar Int'l Marketing Corp.*, 752 F. Supp. 638, 639-640 (S.D.N.Y. 1990) (jurisdictional objection could not be raised on motion to vacate where issue had been argued to the arbitrators; "To find otherwise would allow a party to participate in an arbitration, with the assurance that if it loses it may later challenge whether it had ever agreed to arbitration. Such a result is contrary to the clear policy favoring arbitration").

Beyond this, the Third Circuit's rule would also dramatically increase the workload of the courts. It is well understood that arbitration reduces pressure on court dockets. Indeed, that was a purpose of the Federal Arbitration Act. See, *e.g.*, *Hearing on S. 4213 and S. 4214 Before a Subcomm. of the Senate Comm. on the Judiciary*, 67th Cong., 4th Sess. 14 (1923) (the Secretary of Commerce stated that there was an "urgent need" for the Act because of "[t]he clogging of our courts"; and the ABA reported that the legislation would "reduce the congestion in the Federal and State courts"); Grossman, *The Need of Arbitration to Relieve the Congestion in the Courts*, 10 Acad. Pol. Sci. Procs. 517 (1923), reprinted in *Selected Articles on Commercial Arbitra-*

tion 33 (D. Bloomfield ed. 1927). Given the currently overloaded condition of federal dockets—and predicted increases in the workload of the federal courts over the coming decades (see Committee on Long Range Planning, Judicial Conference of the United States, *Proposed Long Range Plan for the Federal Courts* 127-129 (Nov. 1994 Draft))—the diversion of cases from litigation remains an important public benefit of the widespread use of arbitration fostered by the Act and its equivalents in the labor relations area. See *International Ass'n of Machinists & Aerospace Workers, Lodge No. 1000* v. *General Elec. Co.*, 865 F.2d 902, 904 (7th Cir. 1989). The Third Circuit's ruling that courts must consider arbitrability *de novo* although the parties have elected to present that issue to the arbitrators for decision defeats this important purpose and places an entirely unnecessary burden on courts, turning the application of sections 9 and 10 of the Act into a full-fledged inquiry into arbitral jurisdiction.

During 1990-1992 over 17,000 securities arbitrations were concluded at the major securities industry Exchanges and other Self-Regulatory Organizations. Over 63,000 arbitration claims were filed with the American Arbitration Association in 1993. National Futures Ass'n *et al. Amicus* Br. in Support of Petition for Cert. 4-6. As these statistics starkly reveal, the Third Circuit's approach could generate a substantial amount of additional litigation. Although the proportion of cases in which the question of arbitrability is submitted to the arbitrator appears to be undocumented, that proportion need not be large to impose a heavy additional burden on courts saddled with the Third Circuit's demanding standard of review. And in the labor area it is "common industrial practice to give to the arbitrator the task of deciding his own jurisdiction." R. Gorman, *Basic Text on Labor Law* at 554. *De novo* review of arbitrators' decisions on jurisdiction, despite the parties' grant of authority to the

arbitrator to decide that issue, predictably would add immensely to the resources consumed by judicial review.

"[W]hen the losing party in arbitration asks a court not to give effect to an award, it is asking that the conclusiveness which is at the heart of the process be withheld." Comment, *Judicial Deference to Arbitral Determinations: Continuing Problems of Power and Finality*, 23 U.C.L.A. L. Rev. 936, 949 (1976). There is no warrant in the text, structure, or history of the Arbitration Act to erode the conclusiveness of arbitral awards by requiring a higher standard of review for jurisdictional issues submitted to the arbitrator than for other issues—especially since the objecting party could have submitted the jurisdictional issue to the court before the arbitration took place.

C. Several Courts Of Appeals Have Held That When The Parties Submit The Issue Of Jurisdiction To Arbitration, The Arbitrator's Decision Is Entitled To Great Deference

Considering the numerous advantages of according deferential review to arbitrability determinations when the parties have submitted that issue to the arbitrator, it is not surprising that this approach has already garnered considerable support in the lower courts. The Eighth Circuit has noted a "growing consensus in the circuits * * * that the parties may impliedly consent * * * to arbitration" of the issue of jurisdiction by "arguing before the arbitrator not only the merits of a dispute, but also the question of arbitrability." *Franklin Electric Co.*, 886 F.2d at 191-192. As an earlier panel of the Third Circuit put it:

> The question of arbitrability—whether the parties contracted to arbitrate a particular grievance—is undeniably a legal issue for judicial determination. Unless the parties provide otherwise, a court, not an arbitrator, should resolve the jurisdictional issue of

> what forum should decide the merits of a claim. *If the parties submit the issue of arbitrability to the arbitrator, however, a court is obliged to give the arbitrator's decision regarding the arbitrability of a matter the same deference due an arbitrator's decision on the merits.*

United Indus. Workers v. *Virgin Islands*, 987 F.2d 162, 167 (3d Cir. 1993) (emphasis added, citations omitted).

The Sixth Circuit made the same point in *Vic Wertz Distributing Co.* v. *Teamsters Local 1038*, 898 F.2d 1136 (6th Cir. 1990):

> In the present case, the parties submitted the issue of arbitrability to the arbitrator rather than reserving the question for initial determination by the court. Agreement to have the arbitrator decide the issue of arbitrability "may be implied from the conduct of the parties in the arbitration setting." Because the parties "clearly and unmistakably" submitted the issue of arbitrability to the arbitrator without reservation, we will review the arbitrator's decision on arbitrability under the same deferential standard employed when reviewing an arbitrator's ruling on the merits.

Id. at 1140 (citation omitted). See also *Interstate Brands Corp.* v. *Chauffeurs Local Union No. 135*, 909 F.2d 885, 890 (6th Cir. 1990) (where "the parties submitted the issue of arbitrability to the arbitrator in the first instance," deference is owed to the arbitrator's ruling on that issue), cert. denied, 499 U.S. 905 (1991).

In *George Day Constr. Co.*, 722 F.2d at 1476, the Ninth Circuit similarly held that review of an arbitrator's decision on arbitrability "was narrowly circumscribed" where "the employer initially submitted the arbitrability question to the

arbitrator." The court of appeals pointed out that a party that believes the arbitrator lacks jurisdiction over a dispute has a number of ways to bring that issue to the court in the first instance. The objector "may refuse to arbitrate the case," so that the party seeking arbitration is "put to the task of petitioning the court to compel arbitration." It may expressly refuse to "giv[e] the arbitrability question to the arbitrator for decision[,] * * * reserving that question for later judicial determination." Or it may "tak[e] the initiative by seeking declaratory and injunctive relief prior to the commencement of arbitration." *Ibid.* When a party presents the arbitrability question to the arbitrator for decision instead of taking any of those steps to "obtai[n] an independent judicial examination of the question of arbitrability," it "delegate[s] that decision to the arbitrator and [the court] may not 'second-guess' him." *Id.* at 1476-1477. See also *Fortune, Alsweet & Eldridge, Inc.* v. *Daniel*, 724 F.2d 1355, 1356-1357 (9th Cir. 1983). Other courts have reached the same result.[4]

The precepts articulated in these labor cases also govern review of arbitration awards under the Federal Arbitration Act. Thus, in cases in which a party has sought to vacate an arbitrator's decision under section 10(a) of the Act, courts have applied a deferential standard of review when the parties expressly or impliedly submitted the question of jurisdiction to the arbitrator along with the merits. See *Comprehensive Accounting Corp.*, 760 F.2d at 139-141; *Amicizia Societa Navegazione* v. *Chilean Nitrate & Iodine*

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[4] See, *e.g.*, *Jones Dairy Farm* v. *Local No. P-1236*, 760 F.2d 173, 175 (7th Cir.), cert. denied, 474 U.S. 845 (1985); *Yorkaire, Inc.* v. *Sheet Metal Workers Local No. 19*, 758 F. Supp. 248, 253 (E.D. Pa. 1990); *Teamsters Local Union No. 533* v. *Herbert Fuel Oil & Trucking Co.*, 543 F. Supp. 831, 834 (S.D.N.Y. 1982).

Sales Corp., 274 F.2d 805, 809 (2d Cir.), cert. denied, 363 U.S. 843 (1960); *Halley Optical Corp.*, 752 F. Supp. at 640.

D. Because Respondents Submitted The Issue Of Arbitral Jurisdiction To The Arbitration Panel, The Arbitrators' Decision On That Question Is Entitled To Deference

As the district court found (Pet. App. C14-C18), respondents voluntarily submitted the question whether First Options' claims were arbitrable to the arbitration panel. First Options filed its Statement of Claim against MKI and against the Kaplans individually on July 1, 1989, pursuant to the arbitration rules of the Philadelphia Stock Exchange. C.A. App. A62. The Kaplans filed objections to the jurisdiction of the Exchange and its Arbitration Committee on July 24, 1989. Pet. App. A10-A11. That same day, however, the Kaplans also filed responses denying liability, which addressed the merits of First Options' claims. *Id.* at A10. In addition, Manuel Kaplan filed counterclaims against First Options seeking $10 million in damages for breach of contract, interference with prospective business opportunities, and libel and slander. *Ibid.* Later, at a pre-hearing discovery conference on February 26, 1990, the Kaplans withdrew their prior objections to the arbitrators' jurisdiction. *Id.* at C15.

Nearly two years later, on the eve of the arbitration hearing, the Kaplans changed their minds again and renewed their jurisdictional objections. The way in which they did so is of critical importance. The Kaplans did not seek declaratory or injunctive relief in district court to halt the arbitration proceeding on grounds of lack of arbitral jurisdiction. Nor did they refuse to participate in the arbitration at all, which would have given First Options the opportunity to move to compel arbitration under section 4 of the Arbitration Act. Had the Kaplans taken either of these steps, they would have

ensured that the question whether the arbitration panel had jurisdiction would come before the district court in the first instance.

Instead, the Kaplans filed a Motion to Dismiss for Lack of Jurisdiction, and a memorandum of law in support of that motion, *with the arbitration panel*. Pet. App. A11, C16; C.A. App. 194-205. In doing so, they expressly submitted the question of arbitrability for the panel's decision. Then, after the arbitrators denied their motion to dismiss (J.A. 39), the Kaplans participated in eight days of arbitration hearings on the substance of the dispute, defending against First Options' claims and pursuing Manuel Kaplan's counterclaims. The arbitrators issued an award in favor of First Options and denied the counterclaims. Pet. App. A12; J.A. 40-43.

In line with other courts that have analyzed similar circumstances (see pages 27-30, *supra*), the district court held that the Kaplans' actions "manifest[ed] a clear acceptance of the arbitration panel's authority" to determine arbitrability and that the panel's ruling on that issue was therefore to be reviewed "like any other arbitration decision only for a manifest disregard of law." Pet. App. C18. Applying that standard, the district court reviewed the documents that formed the parties' Workout Agreement. It held that because "[t]he Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties," and also in light of "the well-established federal policy favoring arbitration" (*id.* at C13), the arbitration panel's determination that it had jurisdiction was not in "manifest disregard" of the law and its award should be confirmed. The court of appeals did not dispute the facts underlying the district court's decision

(many of which had been stipulated by the parties).[5] It simply concluded that "district courts should independently decide whether an arbitration panel has jurisdiction," declining to accord the arbitrators' ruling deference although the Kaplans had presented their jurisdictional objections to the panel and had then participated in arbitration of the merits of the claims and counterclaims. *Id.* at A14.

For the reasons we have already set out, the court of appeals' decision is insupportable. By failing to make use of the methods available to obtain an advance judicial ruling on arbitrability, by expressly presenting their jurisdictional objections for determination by the arbitration panel in their motion to dismiss, and by fully participating in the arbitration on the substance of the claims and counterclaims once that motion was denied, the Kaplans consented to arbitral determination of jurisdiction and waived the right to have the court rule on arbitrability in the first instance. Any other rule would significantly undermine the very benefits that the Federal Arbitration Act is designed to secure and promote, thwarting the speed and finality of consensual arbitration and wasting the resources of the federal courts, arbitrators, and parties alike.

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[5] In the district court, the parties stipulated that (1) the Kaplans filed responses to First Options' claims "denying liability" (J.A. 54, ¶ 3); (2) "Mr. Kaplan filed counterclaims against First Options * * * seeking $10,000,000 * * * for breach of contract, interference with prospective business opportunity and libel and slander" (*ibid.*); (3) the Kaplans withdrew their "jurisdiction objections from consideration at the February 26, 1990 discovery conference" and "thereafter participated without objection in th[at] pre-hearing conference" (*id.* at 55, ¶ 5); and (4) "[o]n January 6, 1992, the Kaplans filed a motion and supporting memorandum seeking the dismissal of the claims against them for lack of jurisdiction," which "[t]he arbitration panel denied." *Id.* at 55, ¶¶ 11-12.

II. IN REVIEWING THE DISTRICT COURT'S CONFIRMATION OF THE ARBITRATION AWARD IN THIS CASE, THE COURT OF APPEALS SHOULD NOT HAVE REEXAMINED THE ARBITRABILITY ISSUE *DE NOVO*

In reviewing the district court's denial of the Kaplans' motion to vacate the arbitration award, the Third Circuit (Pet. App. A13) applied the *de novo* standard it previously articulated in *Mutual Fire, Marine & Inland Ins. Co.* v. *Norad Reinsurance Co.*, 868 F.2d 52, 56 (3d Cir. 1989):

> In reviewing the district court's denial of appellant's motion to vacate the arbitration award, this Court will stand in the shoes of the district court and determine whether appellants were entitled to vacate the arbitration award pursuant to 9 U.S.C. § 10(d).

See also *Colonial Penn Ins. Co.* v. *Omaha Indem. Co.*, 943 F.2d 327, 331 (3d Cir. 1991).

The court of appeals' *de novo* review of the district court's decision is particularly troublesome because it is coupled with its ruling that district courts should review arbitral jurisdiction decisions *de novo*. The Third Circuit's rule thus gives parties *three* opportunities to litigate arbitrability *de novo*: once before the arbitration panel, a second time before the district court, and yet a third time before the court of appeals. It is hard to conceive of a set of rules more hostile to the fundamental principle that courts should defer to arbitral decisions on issues the parties submit to the arbitrator, or one more wasteful of appellate resources.

This Court should reject the Third Circuit's approach and either adopt the bifurcated standard of review used by the Eleventh Circuit, or hold that the ordinary standards of appellate review should be applied. Under either alternative,

the Third Circuit's decision vacating the arbitration award in this case cannot stand.

A. As The Eleventh Circuit Has Held, Courts Of Appeals Should Apply A Deferential Standard When Reviewing District Court Decisions Confirming Or Refusing To Vacate Arbitration Awards

The Eleventh Circuit has adopted a hybrid standard of appellate review that is very different from the standard applied by the Third Circuit in this case. The Eleventh Circuit examines a district court's *confirmation* of an arbitration award using a deferential "abuse of discretion" standard, but reviews *vacation* of an award *de novo*. *Robbins* v. *Day*, 954 F.2d 679, 681-682 (11th Cir.), cert. denied, 113 S. Ct. 201 (1992). "By broadly reviewing the grant of a motion to vacate an arbitration award, while narrowly reviewing confirmation of an award, we emphasize the unique context of arbitration, which requires deferential judicial review to promote the primary advantages of arbitration—speed and finality." *Id.* at 682; see also 4 I. MacNeil, R. Speidel, & T. Stipanowich, *Federal Arbitration Law* at 43:62-43:65 & 1994 Supp. at 43:12-43:13; Kupperman & Freeman, *Selected Topics in Securities Arbitration*, 65 Tul. L. Rev. 1547, 1605 (1991).

The Eleventh Circuit's approach properly reflects federal arbitration policy and derives considerable support from the structure of the Arbitration Act:

> The standard most likely to reflect the strong federal policy favoring arbitration is a hybrid standard—one that requires an appellate court to review confirmation of an award for an abuse of discretion and to review vacation of an award de novo. Such a standard would * * * require rigorous review of rulings vacating awards but only limited review of rulings confirming awards. It would also mirror the structure of section 15 [now renumbered section 16] of the Arbitration Act. Section 15 permits interlocutory appeals of orders favoring litigation over arbitration but not vice-versa. More specifically, it permits interlocutory appeals of orders denying motions to compel arbitration and motions to stay litigation pending arbitration but forbids interlocutory appeals of orders granting motions to compel and motions to stay.

Kupperman & Freeman, *supra*, 65 Tul. L. Rev. at 1605.

Section 10 of the Arbitration Act makes clear that arbitration is not intended as the first step of a three-step adjudicative process. Instead, it is intended to resolve disputes finally and conclusively, with little or no court intervention. The Eleventh Circuit's appellate review standard carries out this important federal policy. By "reversing a district court's denial of a motion to vacate an arbitration only upon abuse of discretion, [the court of appeals] further[s] the presumption that the arbitration proceeding was proper." 954 F.2d at 682.

In applying the Eleventh Circuit's standard, courts of appeals reviewing decisions confirming or refusing to vacate arbitration awards should ascertain whether the district court properly articulated the deferential standard of review. If the district court invoked the correct standard, its decision should not be overturned unless it clearly "misapprehended or grossly misapplied" that standard. *Cf. FTC* v. *Indiana Federation of Dentists*, 476 U.S. 447, 453 (1986) (considering whether court of appeals "misapprehended or grossly misapplied" the substantial evidence test); *Anderson* v. *Bessemer City*, 470 U.S. 546, 566 (1985) (examining whether a court of appeals misapprehended and misapplied the clearly erroneous standard). Any more searching

appellate review would be destructive of the parties' selection of arbitration as an expeditious and conclusive means to resolve disputes.

On the other hand, if the district court vacates or refuses to confirm the arbitration award, on appeal deference continues to be due to arbitration—the process selected by the parties—and not to the district court. *Labor Relations Div.* v. *International Bhd. of Teamsters*, 29 F.3d 742, 745 (1st Cir. 1994). In that circumstance, the court of appeals *should* "stand in the shoes of the district court" and thus should apply the same deferential standard the district court should have applied.

B. Under Ordinary Standards Of Appellate Review, The Court Of Appeals Should Have Upheld The District Court's Ruling

Although we urge this Court to adopt the Eleventh Circuit's framework, in this case the same result (confirmation of the arbitrators' award) should have been reached had the court of appeals properly applied the usual standards of appellate review applicable to nonjury civil cases. Under those standards, a district court's factual findings cannot be disturbed unless they are clearly erroneous; mixed questions of law and fact are also ordinarily entitled to "deferential review"; and conclusions of law are subject to "independent review." *Salve Regina College* v. *Russell*, 499 U.S. 225, 232-233 (1991).

The district court's confirmation of the arbitration panel's jurisdictional holding was largely based on the particular facts of this case, and was therefore entitled to deferential review. As the district court pointed out (Pet. App. C13), interpretation of the ambiguous four-part Workout Agreement (including the Letter Agreement signed by the Kaplans and the Subordinated Loan Agreement that expressly made disputes "relating to * * * the Letter Agreement" subject to

arbitration) depended in part upon facts about "the underlying circumstances and relationships of the parties." It has long been understood that "where the effect of a written instrument depends * * * upon extrinsic facts and circumstances," its meaning is a question "of fact and not of law" and is therefore subject to deferential review. *West* v. *Smith*, 101 U.S. 263, 270 (1879); see also 1 S. Childress & M. Davis, *Federal Standards of Review* 2-168 (2d ed. 1992) ("The clearly erroneous rule generally applies to a finding regarding the intent of the contracting parties").

Other factual issues also played a role in the arbitration panel's decision that it had jurisdiction, including the questions whether the Kaplans intended to waive their jurisdictional objections when they withdrew those objections and participated in a discovery conference which was an integral part of the arbitration proceedings (Pet. App. C15), whether Manuel Kaplan commingled personal funds with those of MKI (*id.* at C28), whether Kaplan "disregarded corporate formalities and siphoned corporate funds" (*id.* at C29) and whether the factual predicates existed to pierce MKI's corporate veil so as to subject Manuel Kaplan to the arbitrators' jurisdiction through MKI's undisputed consent to arbitration. *Id.* at C27-C30. The district court's conclusion that there was "ample support in the record for the arbitrator's decision to pierce the corporate veil" (*id.* at C30) confirmed a factual finding that was not only central to the arbitration panel's resolution of the merits of the dispute, but that was also one of the bases for arbitral jurisdiction asserted by First Options.

The district court's fact-bound conclusion that the arbitrators' jurisdictional decision was not "in manifest disregard of the law" should not have been subjected to *de novo* review, but instead should have been upheld under the clearly erroneous standard. As this Court has observed, a district court's factual analysis is entitled to deference even

when it is based solely on "documentary evidence or inferences from other facts" (*Anderson*, 470 U.S. at 574), rather than on observation of witnesses or on credibility determinations:

> The rationale for deference to the original finder of fact is not limited to the superiority of the trial judge's position to make determinations of credibility. The trial judge's major role is determination of fact, and with experience in fulfilling that role comes expertise. Duplication of the trial judge's efforts in the court of appeals would very likely contribute only negligibly to the accuracy of fact determinations at a huge cost in diversion of judicial resources.

Id. at 574-575. Surely in this case, even more than in most other cases, duplication of the district court's efforts—and thus *triplication* of the arbitrators' efforts—would "contribute only negligibly [if at all] to the accuracy of fact determination at a large cost in diversion of judicial resources" and in frustration of the selection of arbitration as the exclusive means of dispute resolution.

The district court's review of arbitral jurisdiction was based largely on fact and was thus entitled to deference. But even assuming that the district court's confirmation of the arbitration decision could be regarded as a conclusion of law, proper "independent review" by the court of appeals should have led the court to apply the same "manifest disregard" standard that governs a district court's review of an arbitrator's award. See Cohen & Dayton, *supra*, 12 Va. L. Rev. at 273 (statement by a principal draftsman of the Act that appeals would not "restor[e] the technicality and delay of legal procedure" because "the grounds of the appeal are necessarily limited to those allowed for vacating, modifying, or correcting an award. This by itself removed the vast

majority of questions with which appeals are usually concerned").

Rather than independently applying the manifest disregard standard, the Third Circuit improperly substituted its judgment for those of both the district court and the arbitration panel, and reviewed *de novo* all of the factual bases for the arbitration panel's decision and the district court's confirmation of the arbitral award. Pet. App. A15-A52. Independent review does not license the court of appeals to substitute its judgment for that of the arbitrators. If respect for freedom of contract and for the parties' choice of arbitration requires district courts to defer to arbitration decisions, the same policies cannot permit appellate courts to review arbitral awards *de novo*.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

STEPHEN P. BEDELL
TIMOTHY G. MCDERMOTT
Gardner, Carton & Douglas
321 North Clark Street
Chicago, Illinois 60610

KENNETH E. WILE
Bank of America National
Trust & Savings Association
231 South LaSalle Street
Chicago, Illinois 60697

JAMES D. HOLZHAUER
Counsel of Record
TIMOTHY S. BISHOP
JEFFREY W. SARLES
Mayer, Brown & Platt
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

Counsel for Petitioner

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STATUTORY APPENDIX

1. The Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, provides in pertinent part:

> § 3. Stay of proceedings where issue therein referable to arbitration
>
> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.
>
> § 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination
>
> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making

of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect or refusal to perform same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

* * *

§ 6. Application heard as motion

Any application to the court hereunder shall be made and heard in the manner provided by law for the making and hearing of motions, except as otherwise herein expressly provided.

* * *

§ 9. Award of arbitrators; confirmation; jurisdiction; procedure

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made. Notice of the application shall be served upon the adverse party, and thereupon the court shall have jurisdiction of such party as though he had appeared generally in the proceeding. * * *.

§ 10. Same; vacation; grounds; rehearing

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

* * *

§ 11. Same; modification or correction; grounds; order

In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration—

(a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.

(b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

(c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

The order may modify and correct the award, so as to affect the intent thereof and promote justice between the parties.

* * *

§16. Appeals

(a) An appeal may be taken from—

(1) an order—

(A) refusing a stay of any action under section 3 of this title,

(B) denying a petition under section 4 of this title to order arbitration to proceed,

(C) denying an application under section 206 of this title to compel arbitration,

(D) confirming or denying confirmation of an award or partial award, or

(E) modifying, correcting, or vacating an award;

(2) an interlocutory order granting, continuing, or modifying an injunction against an arbitration that is subject to this title; or

(3) a final decision with respect to arbitration that is subject to this title.

(b) Except as otherwise provided in section 1292(b) of title 28, an appeal may not be taken from an interlocutory order—

(1) granting a stay of any action under section 3 of this title;

(2) directing arbitration to proceed under section 4 of this title;

(3) compelling arbitration under section 206 of this title; or

(4) refusing to enjoin an arbitration that is subject to this title.